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FINANCIAL DIGEST

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A MIXED BLESSING

The bounceback in economic activity during the third quarter appears to be a mixed blessing. On the one hand, it has served to intensify the debate over whether the U.S. economy is or is not in a recession. On the other, by enabling U.S. corporations to increase their profits, thus, presumably, their cash flow, the uptick helped prepare business for the Federal Reserve's tightening of monetary policy and reduction of credit availability.

Whether or not the current lull in economic activity is officially declared a recession will depend, not on what happened in the third quarter of this year, but what happens from here on out. If the gross national product adjusted for inflation should decline during the current quarter, as virtually all economists expect, and if it should drop again in the first quarter of 1980, then it would seem likely that the lull will be declared a recession, with the starting date stretching back at least to April, 1979. As was pointed out several weeks ago (Financial Digest—October 1, 1979), it is possible for a period of recession to include one or more positive quarters in the real GNP. This was the case in the 1969-70 recession, which saw the real GNP fall in the first quarter of 1970, rise in the second and third, and fall in the fourth.

As for corporate profits, they apparently bounced back in the third quarter, after declining in the second. Calculations by this Bank based on the government's preliminary estimates of third-quarter gross national product suggest that pretax earnings rose $20 billion, or 8.7 per cent in the third quarter compared with the second, seasonally adjusted. This contrasts with a decline of $5½ billion, or 2.3 per cent in the second quarter compared with the first. Year over year, the gains look better in the third quarter than they did in the second, but they were not quite as good as they were in the first. Pretax profits rose about 17 per cent in the third quarter of 1979 compared with the third quarter of 1978. By contrast, the annual gain in the second quarter was less than ten per cent, following a rise of 31½ per cent in the first quarter of 1979 from the comparable year-before period.

INFLATION HELPED EARNINGS

Not all of these gains were due to improved levels of operations. Profits garnered from higher valued inventories rose by $4¼ billion in the third quarter compared with the second, and accounted for more than a fifth of the quarterly rise in total pretax profits. A glance at the key manufacturing sector reveals the importance of inflation to the third quarter's totals. Industrial production fell more over the third quarter than it did over the second. Further, this was accompanied by less of a decline in manhours worked than was the case in the previous quarter. The net result was that productivity in manufacturing hardly changed at all in the third quarter, whereas it rose nearly one per cent in the second. And while unit labor costs did go up faster in the second quarter than they did in the third, selling prices jumped more than four per cent in the third quarter compared with a 1¼ per cent rise in the second. This produced a sizable improvement in the ratio of prices to unit labor costs in the third quarter compared with a deterioration in the second. The second quarter also suffered a decline in shipments whereas there was an increase in the third quarter.

Whether or not corporate profits will advance further in the fourth quarter will depend on the interaction of several factors. Besides the rate of inflation, corporate earnings will be influenced by the amount of unsold goods that exist in various industries and the trend in final sales. Here the prognosis is spotty. For the most part, inventories do not seem significantly out of line with sales. And the Conference Board's index of consumer confidence turned upward in September, its first monthly increase for this year, suggesting that the trend in final sales could continue strong. However, the Board indicates that the gain in confidence may be short-lived, since the survey was taken before the Federal Reserve's recent moves to tighten money.

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures—Millions of Dollars)

	Week Ending 10/24/79	Change Since Week Ago	Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	122,462	+ 462	+ 1,791
Member Bank Borrowings	2,966	+1,020	+ 1,718
Float	5,316	—2,534	— 218
Total Reserve Bank Credit	135,321	+1,718	+ 1,233
Treasury Deposits with Federal Reserve Banks	3,505	+ 518	—11,872
Currency Outside Banks	109,867	+ 302	+10,054
Member Bank Reserves:			
Required	41,533	—1,037	+ 3,784
Excess (Deficiency)	178	+ 177	— 141
Total Reserves Held	41,711	— 860	+ 3,643
Net Borrowed Reserves	2,618	+1,240	+ 1,907
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	83,029	— 667	— 5,017
		r-Revised	
	10/17/79		
Money Supply ($ Bil., SA) M1	379.5	— 0.7	+4.9%
Money Supply ($ Bil., SA) M2	939.8	+ 0.5	+7.8%

NEW YORK MONEY MARKET

Offering Rates 10/26/79

	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	11.70%	11.90%	11.35%
*Federal Agencies	14.00	14.07	13.70
*Project Notes—Tax Free (46% Taxable Equivalent)	N.A.	N.A.	N.A.
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	14.45	14.45	

‡Finance Company Paper—Prime

5- 14 days	12.00%
15- 29 days	13.75
30- 89 days	13.95
90-179 days	12.88
180-270 days	12.25

‡Industrial Paper—Prime

30- 89 days	13.90
90-120 days	14.00

‡*Bankers' Acceptances

Nov.	13.85%
Dec.	13.85
Jan.	14.00
Feb.	14.00
Mar.	13.90
Apr.	13.80

‡Federal Funds Effective Rate 16.10%

‡Discount Basis *Subject to Availability †Estimated

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'79	$ 2,392	$ 2,330	$ 2,160
Gross National Product (1972 Dollars)*	3rd Q'79	$ 1,431	$ 1,422	$ 1,407
Percent Change, Annual Rate	3rd Q'79	2.4%	—2.3%	3.5%
Change in Consumer Prices (all urban consumers)*	Sept. '79n	13.2%	13.2%	10.8%
Change in Producer Prices*	Sept. '79	16.8%	14.4%	9.6%
Civilian Employment (Thousands of Persons)†	Sept. '79	97,513	96,900	95,010
Unemployment as % of Civilian Labor Force†	Sept. '79	5.8%	6.0%	5.9%
Personal Income*	Sept. '79	$ 1,955	$ 1,943	$ 1,756
Leading Indicators Composite Index (1967=100)†	Aug. '79	139.1	139.1	142.0
Industrial Production Index (1967=100)†	Sept. '79	152.3	151.5	148.6
Net Change in Consumer Instalment Credit†	Aug. '79	$ 2.45	$ 2.44	$ 3.63
U.S. Merchandise Trade Balance†	Aug. '79	—$ 2.36	—$ 1.11	—$ 1.84
Plant and Equipment Expenditures*	4th Q'79	$179.56(a)	$174.74(a)	$163.96
Private Housing Starts (Thousands of Units)*	Sept. '79	1,881	1,806	1,948
New Construction Expenditures*	Aug. '79	$ 229.2	$ 232.7	$ 210.9
Total Business Inventories†	Aug. '79	$ 417.2	$ 413.8	$ 366.6
Total Business Sales†	Aug. '79	$ 292.7	$ 288.6	$ 259.2

*Seasonally adjusted annual rate †Seasonally adjusted n Newly reported figure. a Anticipated